China's Progress on Letting Yuan Rise 'Insufficient,' U.S. Says

By Ian Katz

May 28 (Bloomberg) -- The Obama administration declined to brand China a currency manipulator while saying the world's fastest-growing economy is making "insufficient" progress on letting the yuan rise.

The U.S. "believes that progress thus far is insufficient and that more rapid progress is needed," the Treasury Department said yesterday in a report to Congress on foreign- exchange markets. The yuan's real exchange rate remains "substantially undervalued" and the department "will continue to closely monitor the pace" of appreciation.

The report, originally due in April, follows Treasury Secretary Timothy F. Geithner 's push for a stronger yuan. Lawmakers including Senator Charles Schumer , a New York Democrat, say the exchange rate gives China an unfair advantage in the global marketplace. In talks this month between the world's two largest economies, China agreed on the upward direction of the currency, while differing with the U.S. on the pace.

"We have differences on the degree of appreciation," Deputy Finance Minister Zhu Guangyao said May 10 in Washington. China's economy will expand 9.6 percent in 2011 and 9.5 percent next year, according to International Monetary Fund projections released last month.

The Treasury Department backed away from the "nuclear option" of calling China a currency manipulator, said Chris Rupkey , chief financial economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. The Group of 20 nations are "going to have something to say on the global imbalances later this year, so it is better to decide these matters in a world forum rather than for the U.S. to take unilateral action."

Congressional Criticism

Rupkey said in e-mailed comments that the "late afternoon release before Memorial Day weekend appears well-timed in order to miss congressional criticism. Nice timing, as a war of words helps no one." The report was released at 4 p.m. yesterday.

The Treasury said "no major trading partner" of the U.S. met the legal standard of improperly manipulating its currency. "Exchange-rate flexibility must play an important role in rebalancing China's economy towards domestic demand-led growth," the department said.

China has allowed the yuan to appreciate by 5.1 percent against the dollar from June 2010 through the end of April 2011, or at a rate of about 6 percent per year in nominal terms, the Treasury said. Since inflation in China is higher than it is in the U.S., the yuan has been rising against the dollar at an annual rate of about 9 percent on a real, inflation-adjusted basis.

Yuan's Increase

By acknowledging the yuan's increase since last year while criticizing the "limited progress," the U.S. "once again takes a calibrated approach to Chinese currency policy," Eswar Prasad , a senior fellow at the Brookings Institution in Washington and a former IMF official, said in an e-mail.

The yuan completed its second consecutive weekly gain on speculation that policy makers will tolerate appreciation to tame inflation. The People's Bank of China set the currency's reference rate 0.04 percent stronger at 6.4898 per dollar yesterday, the highest level since July 2005.

The yuan strengthened 0.02 percent this week to 6.4917 per dollar as of the 4:30 p.m. close in Shanghai, according to the China Foreign Exchange Trade System. It was little changed yesterday and touched 6.4858 on May 26, the strongest level since 1993. The yuan isn't allowed to move more than 0.5 percent either side of the central bank's daily fixing.

Hampers Progress

"China's consistent, large reserve accumulation prolongs a substantial undervaluation and hampers progress toward global rebalancing," the Treasury said. "It is in China's interest to allow the nominal exchange rate to appreciate more rapidly, both against the dollar and against the currencies of its other major trading partners."

China purchases foreign currencies to suppress the value of the yuan. It accumulated $3.04 trillion of foreign-currency reserves as of March, an increase of 24 percent over a year earlier. Its reserves are the world's largest, accounting for 31 percent of the total.

The Treasury "continues to make the right call on China's currency policy," Erin Ennis , vice president of the U.S.-China Business Council, said in a statement yesterday. The council thinks the Obama administration "approach of employing multilateral and bilateral engagement with China is the most useful way to make progress on the exchange-rate issue."

Stronger Yuan

The council's members as of April 21 included Apple Inc.; Chevron Corp.; Citigroup Inc.; JPMorgan Chase & Co.; and Bloomberg LP, the parent of Bloomberg News, according to the group's website.

The Treasury reiterated its view that a stronger yuan would help China contain inflation. Consumer prices in China rose a more-than-estimated 5.3 percent in April from a year earlier.

If China fails to let its currency rise, it faces the risk of higher inflation, an "excessively rapid expansion of domestic credit, and upward pressure on property and equity prices, all of which could threaten future economic growth," according to the report.

"China's real effective exchange rate -- a measure of its overall cost-competitiveness relative to its trading partners -- has appreciated only modestly over the past decade," the Treasury said.

The report was due on April 15. The previous report, due on Oct. 15, 2010, was released on Feb. 4.

International Meetings

In delaying the April report, the Treasury on April 8 cited a series of coming international meetings. In addition to the U.S.-China Strategic and Economic Dialogue, the delay also encompassed meetings of

Group of 20 finance ministers, the World Bank and the IMF.

In February, the Obama administration also declined to brand China a currency manipulator while saying the No. 2 U.S. trading partner made “insufficient” progress on allowing the yuan to rise.

The Obama administration and U.S. lawmakers have said China’s currency policy gives the nation’s exporters an unfair competitive advantage. U.S. concerns have grown as China’s rising economic power put the economic relationship off balance.

Schumer and Senator Jeff Merkley , an Oregon Democrat, called May 6 for a “rebalancing” in the U.S.-China economic relationship. The two lawmakers, who had just returned from a trip to China, said the Chinese need to open their financial sector, address “abnormally low deposit and lending rates” and allow broader market access to foreign firms.

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